

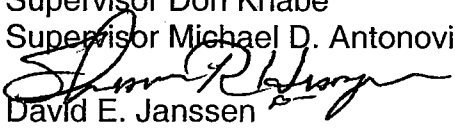


County of Los Angeles
CHIEF ADMINISTRATIVE OFFICE

713 KENNETH HAHN HALL OF ADMINISTRATION • LOS ANGELES, CALIFORNIA 90012
(213) 974-1101
<http://cao.co.la.ca.us>

DAVID E. JANSSEN
Chief Administrative Officer

April 7, 2005

To: Supervisor Gloria Molina, Chair
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

Board of Supervisors
GLORIA MOLINA
First District

YVONNE B. BURKE
Second District

ZEV YAROSLAVSKY
Third District

DON KNABE
Fourth District

MICHAEL D. ANTONOVICH
Fifth District

SACRAMENTO UPDATE

Assembly Pension Hearing

Yesterday, Assembly Budget Subcommittee #4 on State Administration, chaired by Assembly Member Rudy Bermudez, held a hearing on the Governor's pension reform proposal. Present were representatives of the Department of Finance (DOF), the Legislative Analyst's Office, and CalPERS. After CalPERS outlined its opposition based on costs, the Chair spent a few minutes discussing whether the Governor's proposal allows survivor benefits to be provided by public employers. Finally, the Chair decided to submit a list of questions to DOF for a written response and postponed further discussion to a date following receipt of the DOF responses. Attachment I is an excerpt from the staff analysis prepared for the hearing which includes those questions.

Pension Reform Update

On April 4, 2005, the California State Association of Counties (CSAC) and the League of California Cities sent a letter to Governor Schwarzenegger urging his Administration to work with the Legislature to utilize the current momentum for pension reform to establish the principles of reform, and to suggest potential solutions.

CSAC and the League share the Governor's concerns that defined benefit plans suffer from high and volatile costs, taxpayer liability, generous benefits, and a perception of abuse, but they expressed the belief that closing the existing defined benefit plans is not an appropriate solution. Both organizations expressed the view that requiring all new employees to join a defined contribution pension plan will lead to short-term cost increases, uncertainty about future cost savings, problems in recruiting and retaining

quality employees, and employee relations issues. CSAC and the League delivered the same message to members of the Legislature and offered to provide technical expertise and resources to all parties.

Attachment II contains the joint CSAC-League letter and each association's reform principles and potential solutions.

Pursuit of County Position on Legislation

AB 1248 (Umberg), as introduced on February 22, 2005, would prohibit a county from imposing a booking fee on local agencies, colleges, and universities for county costs incurred in processing or booking persons arrested by those entities for a felony offense, by permitting the charging of a fee only for crimes which are not felonies. The measure also expressly prohibits the imposition of booking fees for misdemeanor offenses relating to driving under the influence, domestic violence, battery, and specified sex-related offenses. Current law authorizes a county to impose a booking fee regardless of the offense.

AB 1248 appears to violate a legislative compromise between counties and local entities in the form of SB 1102, which was signed into law last year in recognition of the fiscal crisis facing all local governments. SB 1102 requires booking fees to be reduced to one-half of actual administrative costs beginning in FY 2005-06. AB 1248 would further reduce booking fees, causing an additional fiscal burden for counties not contemplated in the compromise reached in 2004.

The Sheriff's Department recommends that the County oppose AB 1248 because it would result in the loss of as much as \$1 million annually which would otherwise be available for County law enforcement services, and we concur. Consistent with Board policy to oppose measures which reduce County revenues by transferring to the County costs incurred by another jurisdiction, **our Sacramento advocates will oppose AB 1248.**

AB 1248 is sponsored by the California Police Chiefs Association. According to the author's staff, they have not yet been able to document all support and opposition; however, it is supported by numerous cities and city chiefs of police. It is opposed by CSAC, the California State Sheriffs' Association, and numerous counties and county sheriffs, including Los Angeles County Sheriff Lee Baca. AB 1248 is set for hearing on April 13, 2005 in the Assembly Local Government Committee.

Status of County-Interest Legislation

County supported AB 783 (Jones), which would require the State to pay for expenses incurred by local governments in the preparation and conduct of elections proclaimed by the Governor to fill a vacancy in the Legislature, or in the United States

Each Supervisor
April 7, 2005
Page 3

Senate or Congress, passed the Assembly Elections and Redistricting Committee with amendments on April 5, 2005 by a vote of 6 to 0. The bill was amended to be retroactive to January 1, 2005 to allow Sacramento County to seek reimbursement for a recent special congressional election, and to add an urgency clause. This measure now proceeds to the Assembly Appropriations Committee.

We will continue to keep you advised.

DEJ:GK
MAL:JF:MR:MS:ib

Attachment

c: Executive Officer, Board of Supervisors
 County Counsel
 Local 660
 All Department Heads
 Legislative Strategist
 Coalition of County Unions
 California Contract Cities Association
 Independent Cities Association
 League of California Cities
 City Managers Associations
 Buddy Program Participants

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION**APRIL 6, 2005****AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION****Assemblymember Rudy Bermudez, Chair****WEDNESDAY, APRIL 6, 2005, 1:30 PM
STATE CAPITOL, ROOM 437****ITEMS TO BE HEARD**

ITEM	DESCRIPTION	PAGE
0390	Contribution to Judges' Retirement Fund	2
Issue 1	State Contributions	2
0855	California Gambling Control Commission	3
Issue 1	Workload Increase	3
Issue 2	Finance Letter- Fire Marshall Inspection Reimbursement	5
1900	Public Employees' Retirement System	6
Issue 1	Pension Reform	6
Issue 2	Increased Employee Contribution	10
Issue 3	Transfer of Existing Employees to Defined Contribution Plan	12
8120	Commission on Peace Officer Standards and Training	13
Issue 1	Restoration of Prior Year Reductions	13
8380	Department of Personnel Administration	14
Issue 1	Alternate Retirement Plan- Additional Funding	14
Issue 2	Furlough of State Employees	15
Issue 3	Revised Overtime Calculations	16
Issue 4	Elimination of State Holidays	16
Issue 5	Limited Accrual of Vacation	17
9650	Health and Dental Benefits for Annuitants	18
Issue 1	Health Care Premium Rates	18
Issue 2	Federal Prescription Drug Program	18

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION**APRIL 6, 2005****ITEM 1900 PUBLIC EMPLOYEES' RETIREMENT SYSTEM**

The California Public Employees' Retirement System (Cal PERS) administers the retirement and health benefit programs for more than 1.4 million active employees and retirees of state and local agencies. Benefits under the system include: retirement; disability any survivor's benefits. CalPERS also administers a long-term care insurance program for members and eligible individuals.

ISSUE 1: PENSION REFORM

In the Governor's State of the State Address, the Governor proposes a change from a defined benefit retirement plan to a defined contribution program. Under the existing defined benefit program, contributions from the employee and the employer fund a program that provides the employee a fixed monthly payment upon retirement based upon the member's age, final salary and years of service. The state program also provides disability and death survivor benefits to eligible beneficiaries. The California Public Employees' Retirement System has the responsibility for the collection of contributions from the employer, employee and maximize the return on these collections using prudent investment techniques in order to provide adequate funds to meet the obligations of the beneficiaries. Should the liabilities under the system increase, the employer's contribution would increase. As the liabilities decrease, the employer has the option to reduce the level of contributions to reflect the actuarial obligations for that period, or continue the existing level of contributions in order to mitigate shortfalls in future years. Under a defined contribution program, benefits to the retiree are not guaranteed and are limited to the contributions of the employee and the associated investment earnings. Under some variations of a defined contribution plan, employers may provide some or all of the contributions into the plan.

Three legislative proposals relate to a change from defined benefit to defined contribution plans. ACA 5 (December 6, 2004 version) would, effective July 1, 2007, prohibit new public agency employees from participating in a defined benefit pension program, and would only allow the enrollment in a defined contribution plan. Under this proposal, employers would be prohibited from contributing to the defined contribution plan in excess of an unspecified amount. Existing employees would be able to move the present value of his/her interest in the defined benefit program to a defined contribution program.

The subcommittee may want to ask the Administration the following related to ACA 5:

- Does ACA 5 represent the Administration's proposal to transition from a defined benefit to defined contribution plan?

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATIONAPRIL 6, 2005

- How does ACA 5 define a new employee for purposes of the July 1, 2007 effective date? How would this address someone who returns from a leave of absence?
- Does ACA 5 specifically have provisions to provide reciprocity for persons transfer from one retirement system (e.g. State Teachers Retirement, University of California, or 1937 Act county retirement systems)
- What type of disability, and survivor benefits does ACA 5 specifically provide?
- How does ACA 5 calculate the present value of the employee's contribution for transfer to a defined contribution plan? Will this reflect the actual returns of CalPERS or an average rate? Does ACA 5 define the member's interest as the present value of employee's actuarial liability at the time of departure? Does that include the employer's contribution? Investment income on the employer's contribution? Unfunded liabilities?
- Does the present value include contributions where the employer assumed the actuarial liability in lieu of payment by the employee?
- How many employees that are currently involved in the defined benefit program are expected to convert to a defined contribution program?
- What factors will the Administration consider when determining the limit on employer contributions for the defined contribution programs?
- What is the Administration's estimate of the state costs to PERS on closing the fund to new employees? What impact will the closure of the defined benefit plan have on the employer contribution rates assuming that the investment rates of return do not change and there is no other changes in the actuarial assumptions regarding the remaining employees?
- How does closing the defined benefit program affect the investment rate of return for the remaining life of the fund?
- How would closing the defined benefit program affect the fund's plan to eliminate the existing unfunded liability? Does the Administration propose to liquidate the unfunded liability immediately in 2005-06 to minimize the cost of interest associated with the liquidation? What would that cost be?
- Which agency would administer the defined contribution program? What type of investment options would be available under ACA 5 as compared to the current CalPERS portfolio?
- Does ACA 5 provide any fiscal relief to local governments that may experience cash flow problems associated with the closing of a defined benefit plan?

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATIONAPRIL 6, 2005

ACA X1 (January 6, 2005 version) would also limit new employees to public entities hired after July 1, 2007 to a defined contribution plan. It would also allow employees to take the net present value of his/her interest and place it in a defined contribution program. This proposal does not address limits on employer contributions under the defined contribution plan.

The subcommittee may want to ask the Administration the following related to ACA X1:

- Does ACA X1 represent the Administration's proposal to transition from a defined benefit to defined contribution plan?
- How does ACA X1 define a new employee for purposes of the July 1, 2007 effective date? How would this address someone who returns from a leave of absence?
- Does ACA X1 specifically have provisions to provide reciprocity for persons transfer from one retirement system (e.g. State Teachers Retirement, University of California, or 1937 Act counties)-
- What type of disability, and survivor benefits does ACA X1 specifically provide?
- How does ACA X1 calculate the present value of the employee's contribution for transfer to a defined contribution plan? Will this reflect the actual returns of CalPERS or an average rate? Does ACA X1 define the member's interest as the present value of employee's actuarial liability at the time of departure? Does that include the employer's contribution? Investment income on the employer's contribution? Unfunded liabilities?
- Does the present value include contributions where the employer assumed the actuarial liability in lieu of payment by the employee?
- How many employees that are currently involved in the defined benefit program are expected to convert to a defined contribution program?
- What is the Administration's estimate of the state costs to PERS on closing the fund to new employees? What impact will the closure of the defined benefit plan have on the employer contribution rates assuming that the investment rates of return do not change and there is no other changes in the actuarial assumptions regarding the remaining employees?
- How does closing the defined benefit program affect the investment rate of return for the remaining life of the fund?
- How would closing the defined benefit program affect the fund's plan to eliminate the existing unfunded liability? Does the Administration propose to liquidate the

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATIONAPRIL 6, 2005

unfunded liability in 2005-06 to minimize the cost of interest associated with the liquidation? What would that cost be?

- Which agency would administer the defined contribution program? What type of investment options would be available under ACA X1 as compared to the current CalPERS portfolio?
- Does ACA X1 provide any fiscal relief to local governments that may experience cash flow problems associated with the closing of a defined benefit plan?

AB 511(February 16, 2005 version) would limit employer contributions to a defined contribution plan to 6 percent for most employees and 9 percent for peace officer/firefighters. If those employees were not a participant of the Social Security system, the maximum employer contributions would be 3 percent and 4.5 percent higher respectively. This bill would require some matching contributions by employees to qualify for the employer contributions.

The subcommittee may want to seek the following information from the Administration:

- Does AB 511 represent the Administration proposal to transition from a defined benefit plan to a defined contribution plan?
- Does the Administration propose to contribute the maximum amount of employer contribution as identified in AB 511?
- Has the Administration estimated the cost/savings associated with this proposal? If so, is that information available to this subcommittee?

The subcommittee may want to determine the fiscal impact in future years of the Administration's proposal.

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION**APRIL 6, 2005****ISSUE 2: INCREASED EMPLOYEE CONTRIBUTION**

The Administration proposes to evenly share the cost of retirement between employers and employees. Currently, employees pay a fixed percentage of salary toward the total retirement costs. Recently, the State agreed to assume liability for the employee's share of costs for selective bargaining units in lieu of actual increases in base salary. For general administrative workers, the employee's retirement contributions are approximately 5 percent of salary. While the final rates have not been determined for 2005-06, the Governor's Budget proposes an employer contribution rate of 17.022 percent of the employee's salary. The employer and employee costs include the normal costs (prospective costs associated with the benefits guaranteed under the defined benefit programs) and the amortization of unfunded liabilities (unfunded prior costs that could be from the deferral of prior year costs, or the amortization of benefits associated with prior periods). Under the Administration's proposal, employees would now contribute approximately 11 percent of salary, an increase of 6 percent. The Administration has estimated savings of \$208 million from this proposal. The savings assumes that employees will participate in this program as soon as the associated labor bargaining agreements expire. It is not clear if the Administration proposes to give up the ability to temporarily suspend contributions or re-amortize unfunded liabilities as both the employer and employee would participate in any rate changes as opposed to current policy of fixing the employee's contribution while the employer receives the entire benefit from any reduction in the total liability in any particular year.

The subcommittee may want to seek the following information from the Administration:

- Can the Administration provide its savings estimate by collective bargaining unit?
- Why didn't the Administration propose to share only the normal costs rather than include the amortization of costs that the Administration could have liquidated in prior periods (excluding adjustments due to changes in the member's demographic attributes)?
- Does the Administration propose to give up options to defer payments in the future that would increase the total costs due to imputed rate of return on assets of 7.75 percent and therefore increase the costs to both the employee and the State?

SUBCOMMITTEE NO.4 ON STATE ADMINISTRATIONAPRIL 6, 2005

- Does the Administration propose to give employees additional influence in funding of the pension obligations as it proposes to be equal partners in the cost to support the system?
- What does the Administration propose to exchange for the increased employee contribution?

SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION**APRIL 6, 2005****ISSUE 3: TRANSFER OF EXISTING EMPLOYEES TO DEFINED CONTRIBUTION PLANS**

The Administration proposes to allow employees to leave the defined benefit plan. Subsequent to that decision, the employee would receive what had previously been his/her contribution (generally 5 percent of salary). In addition, the State would contribute 50 percent of the normal retirement cost to the employee (estimated to be approximately 5 percent of salary). Since the normal cost would vary from year to year, it is not expected that this payment would be included as part of the salary base. This proposal is estimated to save \$90 million in the Budget Year.

The subcommittee may want to seek the following information from the Administration:

- How many employees are estimated to leave the defined benefit program? What is the average savings per employee? What does the Administration estimate the impact of this proposal in 2006-07 and future years?
- Does the "normal cost" include just the employer's share? Is there any part of the employee's contribution that is part of the normal cost?
- Would the employee that leaves the defined benefit program be able to withdraw funds contributed into that system? How would the amount be determined? Would the Administration propose that the employee be allowed to take out the present value of the employee's interest in the retirement system as specified in ACA 5 and ACA X1?



California State Association of Counties
1100 K Street, Suite 101
Sacramento, CA 95814



LEAGUE
OF CALIFORNIA
CITIES

1400 K Street, Suite 400 • Sacramento, California 95814
Phone: 916.658.8200 Fax: 916.658.8240
www.cacities.org

April 4, 2005

The Honorable Arnold Schwarzenegger
Governor of the State of California
State Capitol
Sacramento, CA 95814

RE: Pension Reform

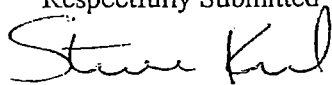
Dear Governor Schwarzenegger:

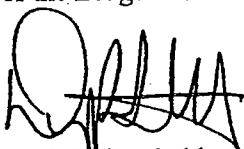
We greatly appreciate your leadership in bringing the pension reform issue to the forefront. Our organizations share your concerns that our defined benefit retirement systems suffer from high costs, cost volatility coupled with taxpayer liability for significant rate swings, generous benefits and the perception of abuse. We do not, however, believe that closing our defined benefit plans and requiring future employees to only participate in defined contribution plans is the appropriate solution. Our analysis leads us to believe that the exclusive defined contribution solution will lead to short-term cost increases, no certainty of future cost savings, employee-relations issues, recruitment and retention difficulties and no assurance of adequate employee retirement benefits.

We urge your Administration, together with the Legislature, to utilize the current momentum for pension reform to jointly establish principles regarding what should constitute pension reform, and consider remedies to those needed reform issues. We are delivering this identical message to legislative leadership. To assist in that debate, CSAC and the League have attached proposals that differ on some solutions but provide our independent analyses of reform principles and legitimate solutions. We remain flexible regarding which of these issues are most appropriate, and provide them to stimulate debate. We hope to participate in that debate and would be pleased to provide technical expertise and resources.

We would also be pleased to respond to any questions or comments regarding this letter. Please feel free to have your staff contact Steve Keil, CSAC Legislative Coordinator of CSAC at 327-7500, ext. 521, and Dwight Stenbakken, Deputy Executive Director of the League at 658-8213.

Respectfully Submitted


Steve Keil


Dwight Stenbakken

cc The Honorable Don Perata, Senate President Pro Tempore
Members of the California State Senate
The Honorable Fabian Nunez, Speaker of the Assembly
Members of the California State Assembly

Attachments

CSAC Guiding Principles for 2005-06 Pension Reform

In response to legislative, administrative, and initiative proposals early this year, CSAC staff has worked with a technical advisory group to develop proposed principles to guide our participation in discussions about reform of public pension systems. Our efforts have been guided by a firm belief that a legislative solution to pension reform is the best course to ensuring reform with clear cost-benefit outcomes for local government retirement systems and for taxpayers.

This document has been prepared with the understanding that it remains a work in progress and should be flexible in order to accommodate CSAC's coalition-building efforts. Staff will continue to modify and refine this document as necessary, under the guidance of our technical advisors and the Government Finance and Operations Policy Committee.

Preamble

Public pension reform has garnered widespread interest and has generated significant debate among policy leaders about the appropriate remedy for actual and perceived abuse, rising costs, and accountability to taxpayers. CSAC welcomes this discussion and approaches the concept of reform with the overarching goal of ensuring public trust in public pension systems, and empowering local elected officials to exercise sound fiduciary management of pensions systems, as well as maintaining a retirement benefit sufficient to assure recruitment and retention of a competent local government workforce. Proposed reforms should meet these broad goals, as well as CSAC's guiding principles.

The guiding principles and reform proposals are listed below and are intended to apply to new public employees hired after June 30, 2007 in both PERS and 1937 Act retirement systems.

Guiding Principles

❖ PROTECT LOCAL CONTROL AND FLEXIBILITY

Local elected officials should be able to develop pension systems that meet the needs of their workforce, maintain principles of sound fiduciary management, and preserve their ability to recruit and retain quality employees for key positions that frequently pay less than comparable positions in the private sector. A statewide mandated retirement system is neither appropriate nor practical, given the diversity of California's communities. Further, a mandated defined contribution retirement system could force a reconsideration of the decision of local governments not to participate in Social Security.

❖ ELIMINATE ABUSE

Public pension systems provide an important public benefit by assisting public agencies to recruit and retain quality employees. Any fraud or abuse must be eliminated to ensure the public trust and to preserve the overall public value of these systems.

❖ REDUCE AND CONTAIN COSTS

Public pension reform should provide for cost relief for government, public employees, and taxpayers.

❖ INCREASE PREDICTABILITY OF COSTS AND BENEFITS FOR EMPLOYEE AND EMPLOYER

Responsible financial planning requires predictability. Employers must be able to predict their financial obligations in future years. Employees should have the security of an appropriate and predictable level of income for their retirement after a career in public service.

- ❖ **STRENGTHEN LOCAL CONTROL TO DEVELOP PLANS WITH EQUITABLE SHARING OF COSTS AND RISKS BETWEEN EMPLOYEE AND EMPLOYER**
Equitable sharing of pension costs and risks promotes shared responsibility for the financial health of pension systems and reduces the incentive for either employees or employers to advocate changes that result in disproportionate costs to the other party, while diminishing the exclusive impact on employers for costs resulting from increases in unfunded liability.
- ❖ **INCREASE PENSION SYSTEM ACCOUNTABILITY**
Public pension systems boards have a constitutional duty to (a) protect administration of the system to ensure benefits are available to members and (b) minimize employer costs. The constitutional provisions and state statutes governing such boards should promote responsible financial management and discourage conflicts of interest.

Reform Proposals

The following proposals represent specific reforms that serve to promote the principles outlined above. Proposals that directly affect employee benefits are intended to apply only to employees hired after June 30, 2007.

- ❖ Restrict public safety retirement eligibility to only those groups of employees who must endanger their own physical safety to protect the public as a major component of their employment.
- ❖ Establish a formula cap for public safety at 2% at 50 and a formula cap of 2% at 60 for miscellaneous employees. The cost of any defined benefit or defined contribution retirement enhancements beyond the base pension formula must be paid in full by employee contributions unless the employer agrees to share not more than 50% of the cost.
- ❖ Require that "final compensation" be calculated using highest consecutive three-year average, as opposed to a single highest year.
- ❖ Provide local agencies the option to implement defined contribution retirement plans within both PERS and 1937 Act systems, as stand-alone benefits or hybrid systems. Remove barriers to providing defined contribution plans to individual employee units within retirement membership categories.
- ❖ Amend the County Employees Retirement Act to eliminate the cost of the *Ventura* court decision by removing factors outside direct salary in determining "final compensation." Note: awaiting definition of "direct salary."
- ❖ Limit application of pension formula increases to prospective service in order to avoid unfunded liability resulting from extension of benefits retroactively. All costs for the extension of retroactive benefits are the sole responsibility of the employee.
- ❖ Limit pension benefits to career employees by excluding from eligibility temporary employees and contract employees. Within the PERS system, seek a definition of "employee" that restricts the effect of the *Cargill v. Metropolitan Water District* case.
- ❖ Require that surplus excess earnings be used according to the following priorities: pay down unfunded liability, offset employer cost for Pension Obligation Bond (POB) debt service, and pay for benefits in effect as of January 1, 2006. Surplus excess earnings may not be used to pay for enhanced pension benefits.
- ❖ Utilization of rate stabilization "best practices" including: 5-year direct rate smoothing; establish a rate funding corridor of 85%-115% of assets after system is 100% funded; if funding level is outside of the corridor, provide a 5-15 year time frame for adjustment of rates to get

back into the funding corridor; rate funding corridor should not be utilized to pay for new benefits; rate stabilization surcharge may be utilized.

- ❖ Pension Obligation Bond debt service should be disclosed in both employer and pension system actuarial reports.
- ❖ Upon agreement, permit employers and employees to share responsibility for all retirement system costs, including unfunded liabilities.
- ❖ Retirement boards and arbiters should not have the authority to grant pension formula increases nor should they act as advocates for pension formula increases. Note the PERS mission statement: "Our mission is to advance the financial and health security for all who participate in the System."
- ❖ Clarify the two-fold responsibility of retirement boards to (a) protect retirement system assets for the benefit of participants and (b) minimize employer contributions.
- ❖ Reform Industrial Disability Retirement (IDR) (see attachment).

Attachment

CSAC Pension Reform Issues: Industrial Disability Retirement (IDR)

In response to IDR reform discussions, CSAC traditionally has supported the principle of provision of IDR to safety employees who are unable to continue their safety employment due to a bona fide job-connected disabling injury or illness. CSAC also has traditionally recognized that IDR can be extremely expensive, and that responsible reforms are warranted to limit the cost to truly legitimate claims. Possible reforms include, but are not limited to:

1. IDR should be discontinued for any period of time the disabled employee participates in similar work with another public agency, even if that agency participates in a different pension system. The definition of "similar" work would be based upon the criteria used by the agency pursuant to the *Nolan vs. City of Anaheim* case for original IDR determination.
2. Raise the age limit for the employer to reevaluate disability status of the IDR recipient from 55 to 59. (See SB 105 (Speier).)
3. Employees who qualify for both an IDR and a regular service retirement should be required to choose one or the other option, and the current practice of providing both benefits by tax sheltering 50% of the service retirement for such employees should be discontinued. This would not apply to other Workers' Compensation benefits for which the employee may be qualified.
4. The determination of IDR should be based upon "predominant cause," i.e. a job-connected illness or injury is the principal causation of the disability.

"Rebuttable presumptions" shall not constitute causation for IDR. Some disabling injuries and illnesses for safety employees are deemed to be rebuttable presumptions (including heart, cancer, pneumonia, meningitis, hernia, blood-borne pathogen, biochemical substances, and lower back). This is true for causation standards for PERS IDR, which is linked to workers' compensation causation, and is true for 1937 Act Retirement systems for "blood-borne pathogens." This generally means that they are deemed job connected, unless the employer can prove otherwise, unlike other injuries for which the employee must demonstrate at least a de minimus job nexus. The date of application by an employer for a successful IDR is the effective start date of the IDR. This date is established regardless of any existing leave balances available to the employee or the employee's participation in a rehabilitation program. Employees will qualify for advance IDR payments while awaiting resolution of the application pursuant to Labor Code Section 4850.3.

5. Eliminate overlapping IDR benefits and workers' compensation benefits when payable for the same injury by establishing an offset between the two systems. (See SB 916 (Speier), AB 514 (Richman).)
6. If some or all of the above cost saving reforms can be achieved, support for increased IDR benefits for employees who are totally disabled from any work (as opposed to occupationally disabled) as part of a package of reforms.

PENSION REFORM IN CALIFORNIA
League of California Cities
March 1, 2005

For close to 60 years California state and local governments have offered "defined benefit" retirement plans to their employees which provide a guaranteed annual pension based upon retirement age, years of service, and some period of highest salary (typically the last one or three years of work). These plans generally provide an annual cost-of-living adjustment and additional inflation protection that maintains the purchasing power over time at a specified minimum level. The Public Employee's Retirement System (PERS), the State Teachers' Retirement System (STRS), and a variety of individual cities and counties administer these retirement plans.

Over the years local and state government retirement costs have risen and fallen based on two principal factors: (1) the investment returns of the various systems; and (2) the level of benefit payments provided to employees. In the late 1990s the California legislature enacted dramatic benefit enhancements for public employees in the PERS system that were optional for participating local governments. Some local governments adopted these benefit enhancement plans—for a variety of reasons, typically to retain employees and at times at a shared cost with the employees. When the retirement systems suffered serious investment losses in the early part of this decade, these losses combined with the benefit enhancements to cause dramatic increases in employer contribution rates.

Defined Contribution Mandate Proposed

In the fall of 2004 a proposed constitutional and statutory initiative (File No. SA2005RF0007) was filed that would close all state and local public sector defined benefit plans (including locally administered plans) to new entrants effective July 1, 2007. Employees hired after that date could only enroll in defined contribution retirement plans. Defined contribution plans provide fixed annual employer contributions to employee accounts that are invested, along with employee contributions. Unlike defined benefit plans, the employee has no guaranteed pension benefit and employers never incur any unfunded liabilities.

The initiative (which has a legislative counterpart by Assembly Member Richman) would establish maximum employer contributions of 9 percent for police officers and firefighters and 6 percent for other employees, assuming participation in federal Social Security (3 percent higher if no Social Security). Local agencies could exceed these limits with a two-thirds vote of their electorate. The state could do so with a three-fourths vote of both houses of the Legislature in two consecutive sessions. Mr. Richman has informed the League in a letter dated February 17 that he is willing to enter into negotiations to avoid the need for the initiative.

In his 2005 State of the State message, Governor Schwarzenegger recommended a defined contribution pension mandate for new state and local employees. In a presentation to the League board of directors on February 25, 2005 Tom Campbell,

Director of Finance, explained the Governor's proposal contains no caps on employer contribution and would not require lower state or local contributions. It would simply remove the risk of increased costs to the taxpayer due to future stock market declines by requiring that all new state and local employees be provided a defined contribution plan in place of the traditional defined benefit plan. Mr. Campbell indicated that in all other respects (e.g., PERS administration, employer contributions, employer contributions, etc.) the plans would be identical.

League Pension Reform Task Force

In late 2004 the Executive Director asked the City Manager's Department's standing task force on PERS to undertake a study of the defined contribution proposal and potential other defined benefit reforms. A group of other appointed and elected officials were subsequently added to the task force to provide broader input, and since early December it has met regularly to study the problems with the existing defined benefit retirement systems and to evaluate the defined contribution proposal. The task force is chaired by Bob LaSala, Lancaster City Manager.

The League also retained the services of a retirement actuary, John Bartel of Bartel Associates, LLC, who worked with the Task Force to ensure its recommendations for reform of the defined benefit system were actuarially sound. He assisted the Board in its discussions. His report to the Pension Reform Task Force, dated February 26, 2005 and entitled *Replacement Ratio Study: Preliminary Results*, is available from the League.

Review and Comment on Discussion Draft Sought

The task force report was reviewed by subcommittee of the Public Employee Relations Policy Committee on Wednesday, February 23, 2005 and forwarded to the League board of directors with a favorable recommendation. On Saturday, February 26, 2005 the board accepted the report, with modifications, and authorized staff to circulate the report as a discussion draft for review and comment. It is important to note the ideas contained in this report represent an initial assessment by the League on pension reform. It is offered for discussion and consideration in the pension reform debate. Comments are requested from League member cities, other local government associations, local government labor organizations, state legislators and the Administration. Comments should be sent to the League of California Cities, c/o Anthony Thomas, Legislative Representative, 1400 K St., Sacramento, CA 95814. athomas@cacities.org

A Framework for Public Pension Reform¹

March 1, 2005

General Pension Reform Principles

Any serious discussion of public pension reform must begin with a set of principles/goals to guide any following recommendations. Until questions about the appropriate role and purpose of public pension benefits in local government compensation packages are answered, it would be at least premature and perhaps self-defeating to make any specific benefit recommendations. In keeping with this philosophy, it is recommended that the following principles precede any benefit recommendations:

- The primary goal of a public pension program should be to provide a full-career employee with pension benefits that maintain the employees' standard of living in retirement.
- The proper level of public pension benefits should be set with the goal of providing a fair and adequate benefit for employees and fiscally sustainable contributions for employers and the taxpayers.
- Public pension benefits should be supported with proper actuarial work to justify pension levels. The Legislature should reject any and all attempts to establish pension benefits that bear no relation to proper actuarial assumptions and work.
- Pension benefits should be viewed in the context of an overall compensation structure whose goal is the recruitment and retention of employees in public sector jobs. In recognition of competitive market forces, any change in the structure of retirement benefits must be evaluated in concert with other adjustments in compensation necessary to continue to attract and retain an experienced and qualified workforce.
- The reciprocity of pension benefits within the public sector should be maintained to ensure recruitment and retention of skilled public employees - particularly in light of the retirement of the post World War II "Baby Boom" generation which will result in unprecedented demand for public sector employees.
- Perceived abuses of the current defined benefit retirement programs need to be addressed. Benefit plans which result in retirement benefits which exceed the levels established as appropriate to maintain employees' standard of living should be reformed. It is in the interest of all public employees, employers and taxpayers that retirement programs are fair, economically sustainable and provide for adequate benefits for all career public employees, *without providing excessive benefits for a select few.*

¹ This report constitutes the recommendations of the League Pension Reform Task Force that was accepted by the League of California Cities Board of Directors for distribution as a discussion draft.

- The obligation to properly manage public pension systems is a fiduciary responsibility that is shared by PERS, employers and employees. This joint responsibility is necessary to provide quality services while ensuring long-term fiscal stability. These parties need to be held responsible to ensure a high level of protection against mismanagement of public resources that could jeopardize a community's ability to maintain services and provide fair compensation for its workforce.
- Charter cities with independent pension systems should retain the constitutional discretion to manage and fund such pension plans.

Reform Recommendations

Public employee defined benefit programs have been appropriately criticized in a number of areas. The following reform recommendations address short-comings within some defined benefit retirement programs, while preserving the aspects of the program that have served the employees, employers and taxpayers of California well for over 60 years.

Pension Benefit Levels

Principles: Public pension benefit plans should:

- Allow career-employees to maintain standard of living post-retirement.
- Be designed with consideration of age at retirement, length of service, compensation level and applicability of Social Security.
- Be supported with proper actuarial work to justify pension levels. The Legislature should reject any and all attempts to establish pension benefits that bear no relation to proper actuarial assumptions and work.
- Promote career public service without creating incentives to work past retirement age, nor disincentive to early retirement. Employees who voluntarily choose to either work beyond retirement age or retire early should not be penalized or rewarded.

Recommendations

- Maintain the defined benefit plan as the central pension plan for public employees in California.
- Rollback/repeal public retirement plans that provide benefits in excess of levels required to maintain a fair, standard of living² that are not financially sustainable and may have no actuarial justification. The new and exclusive benefit formulas to achieve these goals should be:

² This should be determined in accordance with a Cal PERS 2001 target replacement benefit study and/or the Aon Georgia State Replacement Ration Study (6th update since 1988).

1. **Safety Employees:** 3% @ 55 formula, offset by 50% of anticipated social security benefit for safety employees with social security coverage. Safety employees retain the current cap on retirement at 90% of final compensation.
 2. **Miscellaneous Employees(Non-safety):** 2% @ 55 formula, offset by 50% of anticipated social security benefit for miscellaneous employees with social security coverage. A cap of 100% of final compensation is placed on newly-hired, miscellaneous(non-safety) employees.
- The above formulas would incorporate “Three-Year-Average” for “final compensation” calculation. All “Highest Final Year” compensation calculations would be repealed for newly-hired employees.
 - Provide alternatives to a defined benefit plan for job classifications not intended for career public service employment.
 - Give employers greater flexibility to determine when a part-time employee is entitled to public pension benefits. The current hourly threshold in PERS is too low.

Rate Volatility

Principles

- Responsible fiscal planning suggests the need to “manage” volatility in defined benefit plan contribution rates.
- Rates have historically been relatively constant and comparable to rates currently paid by most public agency employers.
- Recent rate volatility is primarily due to large fluctuations in annual investment returns for the retirement plan investment portfolios, causing significant changes in plan funding status.
- Normal Costs for defined benefit plans have remained relatively constant over time.

Recommendations

- Public Agency retirement contribution rates, over time, should be constructed to stay within reasonable ranges around the historical “normal cost” of public pension plans in California. Sound actuarial methods should be adopted to limit contribution volatility while maintaining a sound funding policy.
- Establish “reserve” funding for public pension systems that will help smooth the volatility of pension benefit costs. Plan surpluses are to be retained within plan

assets, but should be reserved for amortization of future unfunded liabilities, and should not be used to offset plans' normal cost contribution rates.

Shared Risk

Principles

- Currently, in most local jurisdictions, employers shoulder the burden of rate volatility risk – both positive and negative. This principle should be carefully examined with the intent of better spreading the risk of rate volatility among both employers and employees.
- Negotiated labor agreements containing language whereby employers “pick-up” employees’ retirement contributions are assumed to be part and parcel of a “total compensation” package; this implies that agencies with Employer Paid Member Contributions would also typically reflect correspondingly lower base salaries.

Recommendations

- When employer contribution rates exceed the “normal costs” threshold, employees should be expected to take some of the financial responsibility for those excessive increases.

Disability Retirement

Principles

- Retirement-eligible employees who are injured in the workplace should be entitled to full disability retirement benefits; disability retirement benefits should, however, be tied to individual’s employability and be structured so as to encourage return to work, where applicable.
- Larger disability reform measures should be considered outside of the scope of general pension reform.

Recommendations

- Full tax-exempt disability retirement should be retained for employees who are injured and can not work in any capacity
- Reform the disability pension provisions of public retirement systems to restrict benefits when a public employee can continue to work at the same or similar job after sustaining a work-related injury.

- Employees eligible for disability retirement should be first afforded applicable service retirement benefits, and THEN provided disability retirement benefits up to applicable “cap” on total retirement benefits.

Portability of Plan Benefits

Principles

- Reciprocity of public agency retirement benefits is critical to recruitment of qualified, experienced public sector employees.
- Limiting portability of retirement plan benefits to non-public sector employment helps in the retention of senior and management level employees.

Recommendation

- Any pension reform package should retain transferability of retirement benefits across public sector employers. No employee currently in a defined benefit plan should be required to involuntarily give up a defined benefit formula before retirement.

Tiered Plans

Principles

- Agencies should strive to avoid multi-tiered compensation structures where there are large discrepancies in benefits accruing to employees. In addition to having adverse impacts on recruitment and employee morale, multi-tiered approaches can raise issues of comparable worth and equity.

Recommendations

- Any pension reform measures should seek to minimize disparity between current and prospective public agency employees.
- Any reduction(s) or change(s) to current Defined Benefit plans should be considered in context of other compensation issues that will tend, over time, to “equate” compensation plans within and across public agency employers.

Management Oversight

Principles

- The obligation to properly manage public pension systems is a fiduciary responsibility that is shared by PERS, employers and employees. This joint responsibility is necessary to provide quality services while ensuring long-term fiscal stability. These parties need to be held responsible to ensure a high level of protection

against mismanagement of public resources that could jeopardize a community's ability to maintain services and provide fair compensation for its workforce.

Recommendations

- Public agencies that do not make the Annual Required Contribution under GASB 27 should be made subject to appropriate oversight.
- The membership of the Public Employees and Retirement System Board should be changed to achieve both a better balance of employer and employee representatives as well as a better balance of public agency representatives.

Conclusion

Defined benefit retirement plans have been the traditional approach for close to 60 years in California and have produced fair and sustainable retirement benefits that have been central to recruiting and retaining quality public employees. Defined benefit plans should be retained as the central component of public pension systems in California.